FED WATCH: USHERING IN A NEW ERA

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Last week, President Trump announced his appointment for the next Federal Reserve (Fed) chair, current Fed governor Jerome Powell. The news was widely telegraphed, and the bond market barely felt a ripple as a result. However, earlier this week, another revelation regarding Fed leadership made headlines, as current N.Y. Fed president William Dudley announced his plans to retire in the middle of next year. With the retirement of vice chair Stanley Fischer last month, two of the three top spots at the Fed will now need to be filled.

Time for a quick Fed 101: First up, the FOMC is supposed to consist of 12 members; the seven members of the Board of Governors (which includes chair and vice chair), the N.Y. Fed president, and then on an annual rotating basis, four of the remaining eleven Fed Bank presidents. At last week's FOMC meeting, there were only nine voting members, so President Trump has more slots to fill. Specifically, the vice chair and two governor positions need to still be appointed, and since current chair Janet Yellen is also a Fed governor, when her term expires in February, a new position will then open up as well, assuming of course that she decides to leave and not stay on as a governor.

The role of vice chair typically carries noticeable weight in the markets. However, one could argue that the N.Y. Fed president is perhaps equally as important. The person holding that position is not only a permanent member of the FOMC but also serves as the Committee's vice chair (not to be confused with the aforementioned vice chair role). In addition, this branch of the Fed also implements policy on behalf of the FOMC. These actions include temporary and permanent open market operations, such as buying securities such as Treasuries, which are managed in the System Open Market Account (SOMA), or the Fed's balance sheet, as some have been referring to it lately. The N.Y. Fed also implements foreign exchange policy for the Treasury department. Unlike Fed governors, the next N.Y. Fed president is not appointed by the president of the United States but rather is appointed by the Board of Directors of the New York Fed.

Conclusion

Over the last few years, if the financial markets were looking for insights on potential policy decisions, I emphasized focusing one's attention on the "Fed Triumvirate": chair Yellen, vice chair Fischer and N.Y. president Dudley. With this week's Dudley announcement, it looks like investors will be dealing with a whole new trio going forward. We already know who will be sitting at the top (Powell), but at this time, the rest of the next triad has yet to emerge.

Perhaps more importantly, the known entity is soon-to-be Fed chair Powell. Indeed, this appointment is being viewed as continuity, in terms of what to expect from future monetary policy and, frankly, the next best option if Ms. Yellen was not going to stay in her post. Given this continuity aspect, it seems reasonable to expect that the Fed's already detailed balance sheet normalization process will move forward as planned, especially since Mr. Powell was part of that decision-making process. That leaves potential future rate increases. As of this writing, the fixed income arena is priced for a December rate hike, but the prospects for 2018 are a bit more uncertain. Looking for guidance or insights into Fed thinking for the future, Powell now sits at the head of the new Triumvirate.

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DEFINITIONS

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Federal Open Market Committee (FOMC) : The branch of the Federal Reserve Board that determines the direction of monetary policy.

System Open Market Account (SOMA) : An account that is managed by the Federal Reserve Bank, containing assets acquired through operations in the open market. The assets in SOMA serve as a management tool for the Federal Reserve's assets, a store of liquidity to be used in an emergency event where the need for liquidity arises, and as collateral for the liabilities on the Federal Reserve's balance sheet such as U.S. dollars in circulation.

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.